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IN THE

Supreme Court of the United States

October Term, 1982

W. JAMES PRICE, ALONZO G. DECKER, JR., JAMES PARKER NOLAN, FREDERICK DEANE, JR., JAMES L. O'KEEFE, GREGORY S. DEVINE, FAY A. LeFEVRE, JOHN K. STEVENSON, HAYS T. WATKINS and HOWARD E. SIMPSON, et al.
Petitioners,

v.

PITTSBURGH TERMINAL CORPORATION,
Respondent.

and

W. JAMES PRICE, et al.
Petitioners,

v.

MONROE GUTTMANN, LORETTA GUTTMANN, JANET REES and EVELYN BITTNER,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

I. WHETHER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934 IMPOSES ANY DUTIES TO HOLDERS OF CONVERTIBLE DEBENTURES WHICH ARE MORE EXTENSIVE THAN THE DUTIES ESTABLISHED BY THE TERMS OF THE TRUST INDENTURE PERTAINING TO THE DEBENTURES?

II. WHETHER DIRECTORS OF A CORPORATION CAN BE LIABLE UNDER SECTION 10(b) AND RULE 10b-5 FOR FAILURE TO GIVE NOTICE OF A DIVIDEND DECLARATION ABSENT PROOF THAT THE DIRECTORS INTENDED TO ACT FRAUDULENTLY?

III. WHETHER THE THIRD CIRCUIT ERRED BOTH SUBSTANTIVELY AND PROCEDURALLY IN REVERSING THE JUDGMENT IN FAVOR OF PETITIONERS ON THE BASIS OF S.E.C. RULE 10b-17 WHERE THAT RULE IS INAPPLICABLE TO THE TRANSACTION IN QUESTION AND WHERE THE PLAINTIFFS FAILED TO ASSERT A THEORY OF LIABILITY UNDER THAT RULE IN THEIR COMPLAINTS, PRE-TRIAL STATEMENT OR AT TRIAL?

PARTIES TO THE PROCEEDINGS BEFORE THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The caption of this Petition shows the names of all parties on whose behalf this Petition is filed. The Baltimore and Ohio Railroad Company, The Chesapeake and Ohio Railway Company and Chessie System, Inc. were also parties to the proceedings before the Third Circuit. A separate Petition for Writ of Certiorari has been filed on behalf of those companies. The petitioning individuals do not believe that Supreme Court Rule 28.1 is applicable to them, however, the following information is provided as to the corporate co-petitioners:

1. On November 1, 1980, Chessie System, Inc. merged with a corporation named Seaboard Coastline Industries, Inc. to form a new corporation, CSX Corporation.

2. Following the merger, Chessie System, Inc. ceased to exist as a corporate entity.

3. The Chesapeake and Ohio Railway Company is now a wholly owned subsidiary of CSX Corporation.

4. The Baltimore and Ohio Railroad Company is more than 90% owned by the Chesapeake and Ohio Railway Company.

Dr. Milton S. Eisenhower was also a party to the proceedings before the Third Circuit, however, this Petition is not filed on his behalf.

TABLE OF CONTENTS

PAGE

Questions Presented i

Parties to the Proceedings in the Court Below ii

Table of Contents iii

Table of Authorities iv

Opinions Below 1

Jurisdictional Grounds 2

Statutes and Regulations Involved 2

Statement of the Case 4

Basis of Jurisdiction in the District Court 11

Argument 12

I. Compliance with the terms of the Trust Indenture pertaining to plaintiffs' debentures conclusively establishes that petitioners fulfilled any fiduciary duty which may have been owed to the plaintiffs. 12

II. The Third Circuit's reversal of the District Court judgment in favor of the Petitioners was based a fundamental misunderstanding of the "scienter" requirement set forth in *Ernst & Ernst v. Hochfelder.* 14

III. The Third Circuit erred both substantively and procedurally in predicating liability on violation of a duty purportedly owed by Petitioners under S.E.C. Rule 10b-17. 17

Certificate of Filing Pursuant to Supreme Court Rule 28.2 20

Certificate of Service 21

Appendix A
Opinions of the United States Court of Appeals for the Third Circuit rendered upon entry of the judgment of that court. 12

Appendix B
Opinion and Order of the United States District Court for the Western District of Pennsylvania granting judgment in favor of Petitioners 49a

PAGE

Appendix C
Judgment Order of the United States Court of Appeals for the Third Circuit 87a

Appendix D
Order of the United States Court Appeals for the Third Circuit denying Petitioners' Petition for Rehearing 89a

Appendix E
Verbatim text of 17 Code of Federal Regulations 240.10b-17 ..... 91a

TABLE OF AUTHORITIES

CASES

Aaron v. Securities and Exchange Commission 446 U.S. 680 (1980) 14

Broad v. Rockwell International Corp., 614 F.2d 418 (5th Cir. 1981), vacated on rehearing *en banc* 642 F.2d 929 (5th Cir. 1981), *cert. denied* __ U. S. ___, 102 S.Ct. 506 (1981) 13

Chiarella v. United States, 445 U.S. 222 (1980) ... 12, 17

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) . 14, 16, 18

Lutgert v. Vanderbilt Bank, 408 F.2d 1035 (5th Cir. 1975) 18

McLean v. Alexander, 599 F.2d 1190 (3d Cir. 1979) 14

Price v. Inland Oil Co., 646 F.2d 90 (3d Cir. 1981) 18

STATUTES AND REGULATIONS

Securities Exchange Act of 1934, Section 10(b), 48 Stat. 891, 15 U.S.C. §78j(b) ..... passim

17 Code of Federal Regulations 240.10b-5 ..... passim

17 Code of Federal Regulations 240.10b-17 17-19

OPINIONS BELOW

The opinions of the United States Court of Appeals for the Third Circuit rendered upon the judgment of the Court are reported at 680 F.2d 933 (1982) and at C.C.H. Fed. Sec. Law Rep. ¶98706

The opinion of the United States District Court for the Western District of Pennsylvania rendered on the judgment of that Court is reported at 509 F.Supp. 1002 (1981) and at C.C.H. Fed. Sec. Law Rep. ¶98440

The opinion of the United States Court of Appeals for the Third Circuit rendered on its order reversing the preliminary injunction issued in these actions is reported at 578 F.2d 1375 (1978).

The opinion of the United States District Court for the Western District of Pennsylvania rendered on its order granting a preliminary injunction in these actions is reported at 444 F.Supp. 656 (1978).

JURISDICTIONAL GROUNDS

This Petition seeks a writ of certiorari to the United States Court of Appeal for the Third Circuit with respect to the judgment of that court entered on June 3, 1982. Petitioners' Petition for Rehearing was denied by the Circuit Court of Appeals by Order dated July 8, 1982. This Court has jurisdiction to review the judgment on writ of certiorari by virtue of 28 U.S.C. §1254.

STATUTES AND REGULATIONS INVOLVED

15 U.S.C. §78j. Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

17 C.F.R. §240.10b-5

Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of

interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Verbatim text of 17 C.F.R. §240.10b-17 appears as Appendix E.

STATEMENT OF THE CASE

A. History of the Litigation

This Petition arises from actions brought by holders of Baltimore and Ohio Railroad Company ("B & O") Convertible 4½% Debentures, Series A, maturing January 1, 2010 ("Debentures")[1]. The actions allege violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder by the Securities Exchange Commission ("SEC") and assert various pendent claims.

Plaintiff Pittsburgh Terminal Corporation ("Pittsburgh Terminal") is a Pennsylvania corporation, solely owned by plaintiffs Monroe Guttmann and Loretta Guttmann. On December 28, 1977, Pittsburgh Terminal, as a holder of $94,000 in face amount of Debentures, brought an action for a preliminary injunction to enjoin the B & O, The Chesapeake and Ohio Railway Company ("C & O") and Chessie System, Inc. ("Chessie") from paying to the B & O's shareholders a dividend in the form of stock of a B & O wholly-owned subsidiary, Mid-Allegheny Corporation ("MAC"). Declaration of the dividend had been approved at the B & O board of directors' meeting on December 13, 1977. The District Court granted the motion for preliminary injunction on March 7, 1978. The defendants appealed to the United States Court of Appeals for the Third Circuit and on July 5, 1978, that Court reversed and remanded the case to the District Court based on assurances by defendants' counsel as to the availability of sufficient shares of MAC stock should plaintiffs prevail on merits of their claim. 578 F.2d 1375 (3d Cir. 1978).

---

1. These Debentures are in the face value of $1,000 and before maturity each is convertible into 10 shares of B & O common stock.

On January 22, 1979, plaintiffs Monroe Guttmann, Loretta Guttmann, Janet Rees and Evelyn Bittner brought an action as debentureholders against the B & O, C & O, Chessie and the directors of the B & O, also complaining of the MAC dividend. Pittsburgh Terminal, on February 15, 1979, filed an amended complaint almost identical with the Guttmann complaint. This amended complaint added the directors of the B & O as defendants.

Following extensive discovery, this matter was heard by the District Court sitting without a jury on July 21-24, 1980. On March 10, 1981, the District Court entered judgment in favor of all defendants and dismissed the complaint. 509 F. Supp. 1002 (W.D. Pa. 1981). The District Court found as facts that the B & O directors did not intend to defraud plaintiffs and that their conduct did not constitute an extreme departure from the standard of ordinary care. (The District Court also found that Milton S. Eisenhower was not present at and did not participate in the December 13, 1977 action of the board of directors.) The District Court held as a conclusion of law that plaintiffs failed to prove the requisite scienter to establish a violation of §10(b) and Rule 10b-5. Additionally, the District Court held that a provision of the Trust Indenture pertaining to the plaintiffs' debentures which required ten days notice of "stock" dividends applied only to dividends of B & O shares and did not apply to the dividend of MAC shares.

Plaintiffs took an appeal from the March 10, 1981 order to the United States Court of Appeals for the Third Circuit. (No appeal was taken from the District Court's June 15, 1980 order granting summary judgment in favor of B & O directors Nicholas Camicia, Steven Muller and Cyrus S. Eaton.) The S.E.C. participated in the appeal as

amicus curiae in support of certain of the plaintiffs' contentions. On June 3, 1982 a three judge panel of the Third Circuit, The Honorable Arlin M. Adams dissenting, reversed the judgment of the District Court (except as to director Milton D. Eisenhower) and remanded the actions for a determination of appropriate relief. The B & O directors' timely petition for rehearing was denied by order dated July 8, 1982. This petition for a writ of certiorari was filed on October 6, 1982 pursuant to Supreme Court Rule 28.2. A separate petition for a writ of certiorari has been filed on behalf of the B & O, C & O and Chessie.

B. Factual Background

The petitioning individual defendants are W. James Price, Alonzo G. Decker, Jr., James Parker Nolan, Frederick Deane, Jr., James L. O'Keefe, Gregory S. DeVine, Fay A. LeFevre, John K. Stevenson, Hays T. Watkins and Howard E. Simpson. All these individuals were directors of the B & O as of December 13, 1977. These individuals are outside directors not employed by the B & O with the exception of Mr. Hays Watkins.

Mr. Watkins was President of The Baltimore and Ohio Railroad Company at all times pertinent to the present actions. At his direction a corporate restructuring committee of B & O officers and employees was formed in late 1976. No directors were on this committee. In December, 1977, approximately 99.63 percent of the outstanding shares of B & O common stock were controlled by the C & O. There were thirteen other shareholders. The C & O was a wholly owned subsidiary of Chessie System, Inc.

The purpose of restructuring the B & O was to provide for the more efficient management and utilization of

B & O assets to the benefit of its shareholders. To that end the restructuring committee sought to segregate non-rail, real property held by the B & O into a separate corporate entity in instances where that could be done without undue expense. The principal benefits of segregation lay in grouping non-rail properties within a corporate entity whose management had special expertise in utilizing such properties, and in eliminating the need to obtain Interstate Commerce Commission approval of decisions affecting those properties.

Similar restructuring via segregation of non-rail assets had been achieved previously by the C & O, as well as by numerous other major railroad companies. In order to remove non-rail assets from jurisdiction of the Interstate Commerce Commission it was necessary that control of the corporation owning the assets, as well as the assets themselves, be removed from the B & O. This was accomplished by transferring the assets to a subsidiary corporation (M.A.C.) and then declaring a dividend of all shares of that subsidiary to shareholders of the B & O. The major shareholder, the C & O, being itself subject to I.C.C. jurisdiction also had to dividend the shares to its parent corporation, Chessie System, Inc.

The dividends in question were declared essentially simultaneously with the transfer of B & O non-rail assets to its subsidiary, Mid-Allegheny Corporation. The declaration and record date for this dividend were identical. This procedure is specifically authorized by the governing Maryland corporate law. Had the number of shareholders of common stock increased beyond fourteen as of December 13, 1977, a registration statement would have had to have been prepared with respect to the dividend. Preparation of a registration statement would have been both expensive and very time consuming due to the num-

ber and size of the properties involved and the lack of recent appraisals. Indeed the method of effecting the restructuring through sales of the B & O non-rail assets to Chessie System, Inc. had been rejected based largely on the difficulty of obtaining current appraisals and the possibility of complaints by minority shareholders as to inadequate consideration. The restructuring plan implemented by the asset transfer and dividend method protected B & O minority shareholders by preserving their proportionate interest in the transferred assets. The directors were so advised.

The B & O directors were informed of the essential purposes of management's complex restructuring program and kept advised as to its general progress during the year of 1977. In November, 1977, a six page memorandum outlining the proposed restructuring was supplied to the directors. This memorandum stated, *inter alia:*

> BACKGROUND
>
> . . .
>
> The Committee examined the legal viability of and the financial costs involved in transferring non-essential rail assets owned directly or indirectly by a railroad to a non-rail subsidiary of the Chessie System which would devote its primary attention to the management and development of these non-rail assets.
>
> . . .
>
> OTHER CONSIDERATIONS
>
> SECURITIES ACT REQUIREMENTS. The dividend by Western Maryland Railway of the stock of Western Maryland Company will require that the stock be registered under the Securities Acts of 1933 and

1934. A prospectus which is required to be approved by the Securities and Exchange Commission prior to the actual distribution of the dividend has been prepared and will be filed with the Commission promptly following the declaration of the dividend.

. . .

The committee has been informed that a "no action" letter can be obtained from the Securities and Exchange Commission to the effect that no registration would be required for the distribution of the stock of Mount Clare Properties, Inc. by B & O. Likewise, a request for the "no action" letter will be filed with the Securities and Exchange Commission promptly following the declaration of the B & O dividend.

OUTSIDE COUNSEL. The entire transaction described herein has been reviewed and approved by Hunton & Williams, Chessie System's outside counsel in Richmond, Virginia. This firm is also assisting Chessie System in complying with the Securities and Exchange Commission registration requirements described above.

(Mid-Allegheny Corporation was substituted for Mount Clare Properties, Inc. in the final version of the restructuring plan.) This memorandum was discussed item by item at the directors November, 1977 meeting.

An additional memorandum dated December 12, 1977 was prepared for Mr. Watkins to assist him in his presentation at the Board of Directors meeting on December 13, 1977. This later memorandum indicated that: "It has been determined that the B & O dividend on the common shares will not result in adverse federal income tax consequences to the minority shareholders and there is no diminution in their ownership interest in B & O

assets." The substance of this memorandum was discussed in detail with the other directors by Mr. Watkins.

The status of the convertible debentures had previously been discussed by Mr. Watkins with his chief legal officer, Roland Donnem. Following legal research and independent readings by Mr. Donnem, Robert Hochwarth and John L. Rogers, Jr., three of the B & O's principal legal counsel, Mr. Watkins was advised that no predeclaration notice needed be given to convertible debenture holders under the terms of the Trust Indenture. Mr. Hochwarth also informed Mr. Donnem that the setting of the dividend declaration date as the record date was proper under applicable Maryland law.

At the December 13, 1977 Board of Directors meeting Mr. Donnem advised the directors that no notice to convertible debenture holders was necessary. Several directors specifically inquired as to the fairness of this transaction with respect to minority shareholders and as to whether the restructuring would diminish the security of the obligations owned to bondholders. The directors were assured that the transaction was fair to the minority shareholders and that the security of the bondholders would not be impaired. Following presentation of the restructuring plan, questions to the officers, and discussion by the directors, the directors adopted the various resolutions implementing the restructuring plan, including *inter alia* the dividend declaration of which plaintiffs complain. Plaintiffs failed to produce any evidence that any director intended to deceive, manipulate or defraud the debentureholders of the B & O, or that the directors acted in other than good faith in approving the restructuring program.

BASIS FOR FEDERAL JURISDICTION IN THE DISTRICT COURT

Jurisdiction of the United States District Court for The Western District of Pennsylvania was based on 15 U.S.C. §78aa, 28 U.S.C. §1332 and upon principles of pendent jurisdiction.

ARGUMENT

I. COMPLIANCE WITH THE TERMS OF THE TRUST INDENTURE PERTAINING TO PLAINTIFFS' DEBENTURES CONCLUSIVELY ESTABLISHES THAT PETITIONERS FULFILLED ANY FIDUCIARY DUTY WHICH MAY HAVE BEEN OWED TO THE PLAINTIFFS.

There can be no liability under §10(b) of the Securities Exchange Act of 1934 absent a breach of a duty owed to the complaining party. *Chiarella v. United States*, 445 U.S. 222 (1980). Additionally, the Court of Appeals for the Fifth Circuit has held that, in the case of convertible debentures, compliance with the terms of the trust indenture conclusively establishes the fulfillment of any and all fiduciary duties to the debentureholders for the purposes of a claim under §10(b):

> "While courts have recognized these [fiduciary] obligations, they have also rejected attempts to expand specific contractual rights to hold that a corporate defendant or a controlling shareholder had a "duty" to the plaintiff that extended beyond performance of the contract. [Citations omitted] Where the defendant had fully complied with the contract, he had discharged his obligation.
>
> We think a similar view is appropriate in this case. If the jury finds that Rockwell fully complied with the terms of the debenture agreement then the fiduciary duty claim should not be reached. Rockwell's duty to the debentureholders was to see that they were treated fairly and that they received what they were entitled under the agreement. Finding that the contract's terms were fully complied with is conclusive demonstration that Rockwell performed its duty."

Broad v. Rockwell International Corp., 614 F.2d 418, 431 (5th Cir. 1981).

The full court held that, assuming the correctness of the panel's analysis, the terms of the indenture had been complied with as a matter of law. *Broad v. Rockwell International Corp.*, 642 F.2d 929, 958-959 (5th Cir. 1981), *cert. denied* 102 S.Ct. 506 (1980).

The relevant provision of the Trust Indenture in the present actions reads as follows:

> Section 12. The Company covenants and agrees that it will not declare and/or pay any dividend on its common stock payable in stock or create any rights to subscribe for stock or securities convertible into stock unless in any such case notice of the taking of a record date for the determination of the stockholders entitled to receive such dividend, distribution or right is given at least ten days prior thereto by at least one publication in an Authorized Newspaper. A copy of each such published notice shall promptly after such publication be filed with the Trustee.

The District Court held, contrary to the plaintiffs' assertion, that "the word 'stock' in Section 12 referred only to the stock of the B & O and that the payment of a dividend in kind of the stock of another corporation was similar to a cash dividend". Accordingly, the District Court dismissed the plaintiffs' pendent claim for alleged breach of the trust indenture. The Third Circuit's opinion did not reach the issue of whether the terms of the Trust Indenture had been violated. More importantly, the opinion totally ignored the Fifth Circuit's holding in *Broad v. Rockwell International Corp.*, *supra*. Circuit Judge Adams's dissenting opinion, however, followed the *Broad* analysis in concluding that "under well-established common law principles [plaintiffs] have no right—unless oth-

erwise specified in the debenture—to notice of corporate actions that may affect the value of the conversion option." 680 F.2d 954. A writ of certiorari should be granted to resolve the conflict between the Third Circuit and Fifth Circuit as to the effect of compliance with the terms of a debenture on the rights of convertible debentureholders to recover for alleged breaches of §10(b) of the Securities Exchange Act of 1934.

II. THE THIRD CIRCUIT'S REVERSAL OF THE DISTRICT COURT JUDGMENT IN FAVOR OF THE PETITIONERS WAS BASED A FUNDAMENTAL MISUNDERSTANDING OF THE "SCIENTER" REQUIREMENT SET FORTH IN ERNST & ERNST V. HOCHFELDER.

Scienter is an essential element of a cause of action alleging violation of §10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b). This is so both in private damage actions, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) and enforcement actions by the S.E.C., *Aaron v. Securities and Exchange Commission*, 446 U.S. 680 (1980). Plaintiff has the burden of proving scienter. *McLean v. Alexander*, 599 F.2d 1190 (3d Cir. 1979). The District Court held as a conclusion of law that "[p]laintiffs failed to establish that the defendant directors had the requisite scienter to establish a violation of Section 10(b) and Rule 10b-5." This holding followed from the District Court's findings of fact that "the directors of the B & O did not intend to defraud plaintiffs" and that "the conduct of the directors of the B & O did not constitute an extreme departure from the standard of ordinary care."

In making these findings the District Court accepted testimony offered on behalf of the defendants that the timing of the complained of dividend declaration was

adopted for the legitimate business purpose of implementing the corporate restructuring plan with a minimum of expense and delay, and that in so acting the board of directors had been advised by legal counsel that no notice of the dividend declaration need be given convertible debentureholders. Similarly, the District Court's findings were supported by the November, 1977 memorandum to the directors indicating that the entire restructuring transaction had been reviewed and approved by outside counsel. Based on this evidence and on the plaintiffs' failure to introduce any evidence showing that the directors intended to defraud the plaintiffs the District Court's Findings of Fact were not "clearly erroneous" within the meaning of Fed. R.Civ.P. 52.

The Third Circuit opinion announcing the judgment the court did not purport to reject the District Court's findings of fact as clearly erroneous. Instead, the Third Circuit in effect held that the District Court had applied a legally incorrect analysis of scienter, stating: "The decision to time the MAC transaction so as to prevent notice to the bondholders until too late was both knowing and intentional. No more is required by the governing cases." 680 F.2d 942.[2] Petitioners maintain that "more" was indeed required and that plaintiffs failed to supply it.

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2. This description of the petitioners' conduct constitutes a crucial mischaracterization suggesting bad faith on the directors' part. The directors did not "prevent notice". They set the declaration and record date for the dividend on the same day (as specifically authorized by Maryland corporate law) after being advised by legal counsel that there was no duty to provide advance notice to the debentureholders and after receiving assurances as to the propriety of the transaction under the securities law generally.

In landmark decision of *Ernst & Ernst v. Hochfelder, supra*, this Court stated:

> "We granted certiorari to resolve the question whether a private cause of action for damages will lie under §10(b) and Rule 10b-5 in the absence of any allegation of 'scienter'—intent to deceive, manipulate, or defraud.[12] . . . we conclude that it will not and therefore we reverse." 425 U.S. 193

In footnote twelve the Court specified:

> "In this opinion the term 'scienter' refers to a mental state embracing intent to deceive, manipulate, or defraud." 425 U.S. 193

In reaching its conclusion and in utilizing the definition set forth above this Court examined both the language and legislative history of §10(b). "The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that §10(b) was intended to proscribe knowing or intentional misconduct." 425 U.S. 197. The preceding sentence must be read as a whole, i.e. §10(b) is directed at "knowing misconduct" not merely knowing conduct: "There is no indication that Congress intended anyone to be made liable for such practices unless he acted other than in good faith. The catchall provision of Section 10(b) should be interpreted no more broadly." *Ernst & Ernst v. Hochfelder*, 425 U.S. 206. This language sustains the District Court's view that a "plan to deceive" or "intent to defraud" is required for liability to exist under §10(b) of the Securities Exchange Act of 1934. A writ of certiorari should be granted to insure correct application of the important principles enunciated in *Ernst & Ernst v. Hochfelder.*

III. THE THIRD CIRCUIT ERRED BOTH SUBSTANTIVELY AND PROCEDURALLY IN PREDICATING LIABILITY ON VIOLATION OF A DUTY PURPORTEDLY OWED BY PETITIONERS UNDER S.E.C. RULE 10b-17.

The Third Circuit's opinion announcing the judgment of the court posited four separate sources of the duty required by *Chiarella v. United States*, 445 U.S. 222 (1980). Petitioners dispute that opinion's analysis of their alleged duties under each of the four sources. The Third Circuit's holding, however, is limited by the terms of Circuit Judge Garth's concurrence to the position that all of the defendants (including the petitioning directors) owed plaintiffs a duty by virtue of S.E.C. Rule 10b-17. The Third Circuit's reliance on that Rule was erronous for several reasons. Rule 10b-17 states in relevant part:

> (a) It shall constitute a "manipulative or deceptive devise or contrivance" as used in section 10(b) of the Act for any *issuer* of a class of securities . . . to fail to give notice in accordance with paragraph (b) of this section of the following actions relating to such class of securities:
>
> > (1) A dividend or other distribution in cash or in kind, except an ordinary interest payment on a debt security, but including a dividend or distribution of any security of the same or another issuer;
> >
> > . . .
>
> (b) Notice shall be deemed to have been given in accordance with this section only if:
>
> > (1) Given to the National Association of Securities Dealers, Inc., no later than ten days prior to the record date involved . . . (emphasis added).

The Third Circuit's holding that Rule 10b-17 imposes a duty on an issuer of securities and its board of directors to provide notice as required by the Rule and that failure to provide such notice gives rise to civil liability under §10(b) breaks new legal ground. This holding is highly suspect since, as set forth in Part II of Circuit Judge Adams's dissenting opinion, Rule 10b-17 was not intended to provide debentureholders with substantive rights outside the scope of the indenture and the MAC dividend does not "relate to" the plaintiffs' debentures within the meaning of the Rule. Additionally, even if the Rule were generally applicable to the present actions, Rule 10b-17 by its terms applies to the "issuer" of a security and is not a proper basis on which to predicate liability of the individual directors of the B & O. Only one prior case has ever discussed the scope of Rule 10b-17, *Lutgert v. Vanderbilt Bank*, 508 F.2d 1035 (5th Cir. 1975). The discussion in that case, which in itself was dictum, does not encompass the facts of the present actions. 508 F.2d 1038-1039.

Furthermore, the Third Circuit's reliance on Rule 10b-17 was improper from a procedural standpoint. The existence and breach of a duty under the Rule was never pleaded in plaintiffs' complaints, amended complaints or pre-trial statement, nor was the issue raised at trial. Thus, any issue as to the applicability of Rule 10b-17 was waived by the plaintiffs under well-established principles followed by both the Third Circuit and this Court. *Price v. Inland Oil Company*, 646 F.2d 90 (3d Cir. 1981), *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976):

> Respondents further contend that *Ernst & Ernst* owed them a direct duty under §17(a) of the 1934 Act and Rule 17a-5 to conduct a proper audit of First Securities and that they may base a private cause of

> action against *Ernst & Ernst* for violation of that duty. Respondents' cause of action, however, was premised solely only the alleged violation of Section 10(b) and Rule 10b-5. During the lengthy history of this litigation they have not amended their original complaint to aver a cause of action under §17(a) and Rule 17a-5. We therefore do not consider that a claim of liability under §17a is properly before us even assuming respondents could assert such a claim independently of Section 10(b). 425 U.S. 194 at n.13.

The Third Circuit's reliance on Rule 10b-17 conflicts not only with principles designed to insure orderly regulation of appellate practice, but also effectively deprived petitioners of their due process right to be heard on the issue upon which that court predicated liability. For these reasons, and because the Third Circuit's substantive holding on this issue was in error a writ of certiorari should be granted.

Respectfully submitted,

SHARLOCK, REPCHECK, ENGEL & MAHLER

By: .....

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CERTIFICATE OF FILING
PURSUANT TO SUPREME COURT RULE 28.2

The undersigned, who is a member of the Bar of this Court, hereby certifies under oath that forty (40) copies of the within Petition for Writ of Certiorari were filed by depositing them at the United States Post Office, Grant Street, Pittsburgh, Pennsylvania 15219 with first class postage prepaid on October 6, 1982.

SHARLOCK, REPCHECK, ENGEL & MAHLER

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(A notarized duplicate of this certificate has been separately filed with the Court.)

CERTIFICATE OF SERVICE

The undersigned, who is a member of the Bar of this Court, hereby certifies that three copies of the within Petition for Writ of Certiorari were served upon the following individuals at the addresses shown below by first class United States Mail, postage prepaid on October 6, 1982:

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